Fixed Income asset class overview

August 2025

Markets had a rough start in August following the release of July's US non-farm payrolls, suggesting a slowdown in the US labour market following the US "Liberation Day" tariffs announcement in April. Later in August, at the Jackson Hole annual meeting, Federal Reserve (Fed) chair Jerome Powell suggested that the balance of economic risks had shifted based on the jobs data release, potentially warranting an adjustment to the Fed's policy stance. As a result, markets began to recover and are now pricing in a high likelihood of a 25 bps interest rate cut at the Fed's September meeting.

Month in review

The US consumer price index (CPI) report for July, which was broadly as expected and didn't show a major impact from tariffs, added momentum to investors' belief that a rate cut is on the horizon.

Later in August, President Trump attempted to fire Lisa Cook, one of the seven members of the Fed's Board of Governors. The combination of moves over the month saw the US yield curve steepen: rate cut expectations lowered near-term yields, but investors demanded greater compensation for holding longer-dated Treasuries as doubts about the Fed's independence gained traction.

In investment grade (IG), credit spreads widened slightly across the US and Europe and remained unchanged in the UK. The primary IG market saw steady activity throughout August, with numerous new issuances, but we found most of these priced at levels that lacked attractive value.

Global high yield (HY) markets delivered positive returns in August (1.0%), taking year-to-date (YTD) performance to 6.0%. US HY relatively outperformed, benefiting from the Fed's dovish signals that lowered Treasury yields and bolstered risk appetite. In contrast, European HY performance was strained due to a combination of macroeconomic uncertainty (weighing on European rates and credit spreads), weaker technicals (new issuance slowed in the summer) and trade-related concerns.

In emerging markets (EM), returns were positive across the board with hard currency sovereigns returning 1.6%, driven by a strong contribution from rates, and a more modest spread contribution. Similarly, hard currency corporates gained 1.3%, with the majority of the return driven by rates. Meanwhile, local currency sovereigns returned 2.2%, bringing YTD performance to 13.8%.

Inflation

August presented a mixed bag of signals on the US inflation front. July's Consumer Prices Index (CPI), which measures consumer price inflation, came in exactly line with expectations, prompting investors to increase the odds of a potential interest rate cut in September. However, a few days later, the Producer Price Index (PPI), which reflects inflation experienced by producers, came in hot, surpassing expectations and making investors concerned about the future trajectory of inflation.

Delving into the specifics, the US headline CPI came in line with expectations, growing 0.2% in July. Over the past 12 months, headline CPI stood at 2.7%, while core CPI was at 3.1%. Although tariffs remain a focal point, their impact was arguably less than feared. The key surprise emerged from services inflation, particularly from the rise in 'supercore' inflation (services inflation excluding rents). Part of the increase in this category can be blamed on air fares, which showed a large month-on-month (MoM) increase on a seasonally adjusted basis. Yet, we should probably not overreact to this increase, as actual air fares, on a non-seasonally adjusted basis, declined in July. Therefore, the higher reported inflation in this category was primarily driven by seasonal adjustment factors, which can be quite volatile and may have been also impacted by the recent volatility in the oil price.

Taking a broader perspective, wages, the key driver of services inflation, remain stable. The labour market is gradually cooling, and so are wages, suggesting limited current upward pressure on service inflation. Moreover, when examining shorter-term inflation trends, such as the three- and six-month annualised CPI, inflation looks to be around or below 2%. To us, this indicates that the near 3% YoY inflation figure is largely due to base effects rather than substantial inflationary pressures from tariffs.

Turning to the PPI, which caught most investors by surprise, the MoM index increased by 0.9%, compared to the 0.2% expected. There are three considerations to make here: firstly, this is a fairly volatile series and therefore we should be cautious to draw any conclusions from a single data point. Secondly, most of the upside surprises came from categories that don't significantly impact the personal consumption expenditures (PCE) index, which ultimately is what the Fed uses to target inflation. Lastly, higher PPI doesn't automatically lead to higher CPI. In a growing economy with rising wages, companies might pass costs onto consumers, but in a slowing economy, businesses often absorb these costs, reducing profit margins. Given the current economic cycle, this latter scenario would seem more probable, in our view, indicating that the primary concern from the PPI report should be shrinking margins and slower growth rather than increased overall inflation.

In summary, inflation data was mixed in July, yet the overarching narrative remains relatively unchanged: inflationary pressures appear contained, and tariffs have only shown limited impact compared to broader expectations. Although the market has interpreted the divergence between CPI and PPI as an indication of accelerating inflation, this interpretation may not be accurate. We believe that another plausible scenario could be that producers are experiencing compressed margins resulting in slower growth, rather than rising inflation.

Developed market sovereigns

August marked a turbulent period for global markets, with multiple dynamics at play. Early in the month, investor sentiment soured as the 1 August tariff deadline lapsed, amplifying concerns about trade disruptions. This was compounded by a disappointing US employment report, stoking fears of an economic slowdown. However, markets quickly rebounded, largely due to Fed Chair Powell's dovish remarks at Jackson Hole, signalling a likely rate cut in September. Despite the recovery, challenges persisted, including unease over the Fed's autonomy, which fuelled rising inflation expectations and a steepening yield curve.

Multiple data releases in August pointed to a downshift in US economic momentum, albeit with mixed signals on inflation. The most dramatic news was the abrupt hiring slowdown -- only 73k jobs were added in July, a major step down and well below consensus (~100k). This pointed to a cooling labour market.

As a result and helped by the more dovish than expected Powell pitch at Jackson Hole, market expectations for Fed policy shifted: by the end of August, futures were pricing in an almost 90% chance of a Fed rate cut at the upcoming September meeting, from a probability that was effectively zero just weeks earlier. Yields on two-year Treasuries plunged as investors bet the Fed would have to ease monetary policy to support the economy.

Turning to the eurozone, we can say that by August 2025 the euro area has achieved a remarkable normalisation in inflation – a stark turnaround from the price surge of the previous year. Headline inflation for July was confirmed at 2.0% YoY, exactly the European Central Bank's (ECB) target and the lowest since early 2022. ECB officials welcomed this development as the urgency for rate hikes evaporated. President Lagarde still struck a cautious tone, emphasising that victory over inflation isn't definitive and that the ECB is prepared to raise rates again if needed.

Employment has stayed relatively resilient, and the unemployment rate across the eurozone held near record lows around 6.4%. Still, business surveys (PMIs) over the summer signalled contraction in manufacturing and only tepid expansion in services.

In the UK, the Bank of England, in its August meeting, cut the Bank Rate by 25 bps to 4%. Notably, the decision was a narrow 5–4 vote, reflecting deep division in the Monetary Policy Committee. It was the BoE's fifth consecutive quarter-point cut in 2025 as it tried to balance a cooling economy on the brink of recession with still-high inflation. The Bank signalled a "wait-and-see" stance going forward, contingent on incoming data.

UK CPI inflation unexpectedly jumped to 3.8% in July, from 3.6% in June. Importantly, core inflation (ex. food, energy, alcohol, tobacco) also rose to 3.8% – indicating that price pressures are broadening, not just isolated.

In Japan, GDP grew at a 1.0% annualised rate in Q2 2025, beating forecasts of roughly 0-0.5% growth. This upside surprise was driven by robust consumer spending and business investment.

Past performance is not a guide to future performance.

Government bond total returns (in local currency)

	10-year yield %	Total return % (1m)	Total return % (ytd)
Treasuries	4.2	1.0	4.4
Bunds	2.7	-0.2	-1.1
Gilts	4.7	-1.0	1.2

Source: Bloomberg, 31 August 2025

Investment grade credit

In August 2025, financial markets experienced significant volatility driven by competing forces, from the heightened anxiety as the 1 August US tariff deadline passed, escalating fears of trade disruptions, to the lacklustre US jobs report which further deepened concerns about a potential economic slowdown and Fed Chair Powell's dovish stance at Jackson Hole, hinting at a possible September rate cut. Persistent worries about the Fed's independence continued to drive inflation expectations higher, contributing to a sharper yield curve.

Against this backdrop, IG credit spreads slightly widened in the month. Global IG spreads finished the month at 82 (3 bps wider). European spreads led the way, tightening 5 bps to 83 bps, whilst US dollar spreads remain the lowest at 80 bps. Sterling spreads were unchanged at 91.

After the mild widening, global IG spreads remain at the 12th percentile when looking at the last 30-year valuations. The primary market saw steady activity throughout August, with numerous new issuances. However, we found most of these priced at levels that lacked attractive value.

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Investment grade total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
US IG	80	1.0	5.4
Euro IG	83	0.0	2.4
UK IG	91	-0.5	3.3

Source: Bloomberg, 31 August 2025

High yield credit

Global HY markets delivered positive performance in August (1.0%) taking YTD performance to 6.0%.

US HY relatively outperformed benefiting from dovish signals from the Fed that lowered Treasury yields and bolstered risk appetite. In contrast, European HY was held back by a combination of macroeconomic uncertainty (weighing on both European rates and spreads), weaker technicals (new issuance slowed in the summer) and trade-related concerns.

Spreads remained tight across most regions with European spreads seeing a little upward pressure. Current levels remain very tight, pricing an almost "perfect" scenario of continued low defaults, stable growth and supportive central bank policy. We maintain a cautious risk posture given current valuations look uncompelling, even though we may still see a moderate spread compression with the deployment of built-up cash over the summer.

Despite tight spreads, yield levels remain relatively compelling - around 6.8% in the US (YTW), 5.1% in Europe (EUR) and 7.1% for HY FRN (USD) – providing meaningful carry in a low-growth environment.

The risk tone in August was cautiously positive. In the US, outperforming sectors included energy (buoyed by stable oil prices) and healthcare, while media lagged due to security-specific credit concerns. In Europe, financials and utilities outperformed, supported by defensive characteristics and stable earnings, while autos and consumer discretionary continue to underperform amid tariff-related uncertainty. Sector dispersion remains pronounced, particularly in the US, offering selective opportunities for active managers.

Rating-wise, US lower-quality (CCC) bonds outperformed reflecting improved sentiment and demand for mid-tier credits. CCC rated bonds remain volatile, but benefited from increased risk appetite. In Europe, BB and B rated bonds continued to dominate performance, while CCCs underperformed due to cautious positioning and limited demand

Outlook

We are reaching the end of reporting season and there have been some alerting numbers, especially among issuers in the consumer and cyclical sectors. Meanwhile, HY spreads continue to tighten, supported by strong technicals and potential positives from interest rate cuts.

We remain cautious on adding risk at current levels and would prefer focusing on stock selection and security-specific opportunities. Alternatively, we will wait for the new issue market reopening in September.

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High yield total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
US HY	282	1.2	6.2
Euro HY	293	0.1	4.3

Source: Bloomberg, 31 August 2025

Emerging market bonds

EM debt returns were positive across the board with hard currency sovereigns returning 1.6%, driven by a strong contribution from rates, and a more modest spread contribution. Hard currency corporates gained 1.3%, with the majority of the return driven by rates. Local currency sovereigns returned 2.2%, bringing YTD performance to 13.8%.

The very broad-based EM rally continued, with only a few countries seeing spreads widening, most of which were CCC rated, including Argentina and Zambia.

EM fundamentals remain robust across both sovereign and corporate segments. Many economies are benefiting from contained inflation and the easing of monetary policy. While the prospect of new US tariffs has led to downward revisions in global growth forecasts, emerging markets are still expected to outpace their developed counterparts. We remain fairly constructive on the pace at which trade agreements are being put into place, allaying fears over a broader, deeper, economic growth slowdown.

A softer US dollar is supportive of local currency returns, and historically, the resumption of a Fed rate-cutting cycle has provided a meaningful tailwind for EM debt. As investors seek to diversify away from US assets, EM debt is increasingly viewed as a relatively stable refuge.

Although spreads continue to compress, yields remain elevated, offering an appealing entry point for those looking to rotate out of lower-yielding, safer assets. A compelling yet sometimes underappreciated feature of the asset class is its ability to deliver yields comparable to, or even exceeding, those found in high-yield markets, while maintaining superior credit quality. With approximately half of the market rated IG and a high degree of diversification, we believe EM debt is well-positioned to attract investor interest.

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Emerging market bonds total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
Local currency government	n/a	2.2	13.8
Hard currency government	302	1.6	8.7
Hard currency corporate	247	1.3	6.3

Source: Bloomberg, 31 August 2025

Currencies

Reversing the short-lived strength seen in July, the dollar declined 1.4% in the month of August, helping boost the majority of currency returns. The dollar fell following market repricing of the Fed's interest rate cutting cycle, with the central bank signalling cuts in September. The uncertainty created by tariffs and other policy shifts also continue to weigh on the dollar.

Within the G-10, all currencies appreciated relative to the dollar aside from the New Zealand dollar, which weakened off the back of expectations for the central bank to expedite their rate cutting cycle to deal with domestic growth and economic issues.

Looking across major currencies, the Colombian peso, South African Rand, and Swedish Krona were among the strongest-performing currencies on a spot basis. Conversely, the Taiwanese dollar and Russian rouble saw the most significant depreciation, with the former facing pressure following renewed threats from Trump on the potential for additional tariffs with the central bank intervening in the market to prop up the currency.

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Key currency pairs

	Change % (1m)	Change % (ytd)
GBP/USD	2.2	7.9
GBP/EUR	-0.1	-4.4
EUR/USD	2.4	12.9

Source: Bloomberg, 31 August 2025

The value of investments will fluctuate, which will cause prices to fall as well as rise and you may not get back the original amount you invested.

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